Remarks of Daniel G. Amstutz
Under Secretary for International Affairs
and Commodity Programs
U.S. Department of Agriculture
Before the American Agricultural Economics Association
Ithaca, New York
August 6, 1984

INTERNATIONAL IMPACT OF U.S. DOMESTIC FARM POLICY

It is an accepted fact that international markets have become an important driving force in the well-being of U.S. agriculture. Until the late 1960s commercial international markets were almost insignificant in many minds for U.S. agricultural products. Farm legislation was primarily inward looking reflecting the perspective of the agricultural sector itself. Farm programs were responsive to a domestically oriented clientele that had little interest or cause for concern with international markets.

During this period, the focus of U.S. international agricultural activities concentrated on collection of country by country statistics on area, yield, production and trade, low key market development, maintenance of our Section 22 [1/] waiver in the GATT and protecting our flexibility to dispose of surplus production into the world market through PL-480 and export subsidies. Domestic agricultural affairs and the international dimension were carried out in separate, unrelated and generally uncoordinated fashion.

By the early 1970s this approach was no longer warranted or possible. As world markets exploded and domestic pressures on food markets grew, it

---

1/ Section 22 of the Agricultural Adjustment Act of 1935, as amended, requires the President to establish import quotas on price supported commodities, irrespective of existing international agreements, whenever imports threaten the ability of the government to carry out the domestic price support program. Since 1951, the U.S. has had a waiver in GATT for the use of Section 22.

became clear that domestic farm programs and international agricultural trade policies would require greater coordination if the United States was to lead the way toward worldwide agricultural trade liberalization. This recognition was slow in coming and its importance to further expansion of U.S. farm exports is not entirely accepted even today. For that reason, let us take a moment to again review the changes that have taken place in the global agricultural and trade environment.

World trade in agriculture rose 15 percent annually during the 1970s. Almost all exporting countries shared in this growth which resulted in a greater dependence on world trade. During this period of rapid growth, internal farm policies had little economic impact on the international trade situation.

It was not until the last four years, when world trade in agricultural products turned downward that the relationship between domestic and international policies became clearly evident for the major trading countries. Europe and Japan particularly were forced to reexamine the relationship between their internal policies and their external trade conflicts. The United States, a long time advocate of greater market orientation in farm policies, began an accelerated effort of pressing vigorously in international fora for reform on international trade rules. At home the Administration maintained its position that free market competition offers the best way to achieve solid, sustainable, long-term growth for both the United States and other agricultural trading countries. To their credit, some of our trading partners have come to accept this position; others have not. Similarly, some of our domestic policy interest groups have recognized the issue's importance, and some have not.

A brief review of our own farm policies illustrates why we continue to press for freer world markets.

Prior to 1933, U.S. farm policy focused on developing our agricultural infrastructure to satisfy a growing internal market. Internal population expansion provided the opportunity for agricultural growth with a minimum of government outlay. Government support was resource oriented, aimed at land disbursal and increasing productivity. Agricultural commodities dominated the nation's exports during this early period even though they were relatively small. As late as 1900, farm exports accounted for three-fourths of total export sales but a relatively small percentage of total agricultural production.

The collapse of farm prices after World War I and the subsequent passage of the Agricultural Adjustment Act of 1933 marked a turning point for U.S. farm policy as the orientation changed from developmental programs to compensatory policies. Programs shifted toward encouraging higher productivity through the use of relatively high and rigid commodity price supports--the goal was to revive the prosperity of the 1910-14 period.

The early part of this second period saw increasing government involvement in agriculture, with commodity prices determined more by government policy than by market forces. The latter part of the period--from the end of World War II through 1960--brought a slow realization that satisfactory incomes for some farmers could not be provided by manipulating commodity prices alone. As a consequence, greater attention was given to community development, rural industrialization, improved education and regional development policies.

Throughout this 30-year period, agricultural trade policy was captive to an inward-looking domestic policy. Surpluses, generated by high price supports, led to a mounting interest in both domestic and foreign disposal

programs. Trade restrictions under Section 22 of the Agricultural Adjustment Act of 1935 and voluntary import restraints sought to protect the established price levels.

A major turning point came in 1963 when wheat producers rejected a mandatory acreage control plan for wheat. The new policy tilt came to full flower with the passage of the Agriculture and Consumer Protection Act of 1973 with a shift to a deficiency payment scheme that provided target price payments to maintain farm income.

During this policy shift the United States went from high price supports and relatively tight controls on output, to greater reliance on the market as a determinant of commodity prices. Obvious exceptions remained, e.g., dairy, tobacco, sugar and peanuts. But for the major commodities, domestic farm programs were adjusted so as to facilitate rather than retard exports into international markets.

The real payoff came after 1972 when an unprecedented growth in the international agricultural market allowed the United States to increase its dominant position in world market. Unfortunately, this ostensible "golden era" led many to conclude that there was no need to be concerned about coordination of domestic and international policies, and in 1981, a new farm bill reversed much of the change of the previous two decades. This coupled with other trends in the world market led exports to drop substantially after 1981. Policy analysts in turn were forced to take a new and urgent look at the changing trade environment and to reassess the policy mix that suddenly was not working.

Thus, U.S. farm policy has come through four distinct periods. During the earliest period, U.S. agriculture was open and accounted for most of the nation's modest foreign exchange earnings but had little impact on the international market.

The second period saw the United States turn inward, generating inflexible per-unit price support programs that resulted in large and expensive surpluses. During this period, only our newly begun P.L. 480 program kept agricultural exports growing, helping to relieve us of part of our burdensome surpluses.

The third period saw a policy shift that laid the foundation for the United States to enter and compete in the international market-place without government export aid.

The latest period, characterized by unprecedented expansion and an increasing reliance on trade, followed by a turndown in our export fortunes, illustrates that internal farm policies can have a significant impact on our international trade prospects.

Impact of U.S. Agricultural Policy

Obviously, adjusting our price policies so that they better conform to rapidly changing market indicators is something that will materially impact on the rest of the world. Our actions affect other countries, perhaps more than their actions affect us.

Three characteristics of U.S. agriculture are of paramount importance in influencing the behavior of international markets. First is the sizeable carryover stocks traditionally maintained by the United States that allow a rapid response to sudden market expansions. Second is an excess capacity in the physical agricultural plant that permits relatively rapid expansion of crop production. And third is a price umbrella effect established by crop loan rates that provides a stabilizing effect in world markets but often limits U.S. competitiveness. These reserve and price support programs have served for many years to cushion production and market fluctuations for the United States and the rest of the world.

By the same token, the United States, virtually alone among grain producers has coupled its domestic support system with a requirement that producers reduce output when there are excess supplies. Unfortunately, experience indicates that the United States alone can no longer adjust excess supplies to world market needs. Most countries continue to increase output during surplus periods rather than cutting back production to slow the growth of surplus stocks. And many importing nations erect import barriers that thrust an even greater measure of price adjustment on market economies, particularly the United States.

Thus, the United States is placed in the position where support and stocking policies, i.e., the farmer owned reserve insulates commodities from the world market, work to its disadvantage during periods of surplus world production. In reality the U.S. domestic price support program holds an umbrella over world prices, increasing foreign production while U.S. production is reduced through acreage reduction programs. Furthermore, rather than allowing the United States the typical position of a low cost price leader where others must adjust their sales to market needs after the price leader has marketed its supply, the U.S. is placed in a position of a residual supplier, and we can market our higher-priced goods only after other nations have exhausted their supplies. In short, our grain policies have operated to the substantial benefit of other exporting countries at the substantial expense of the United States agricultural budget.

Economics of Grain Trade

The historical relationship between U.S. agricultural exports and our commodity loan rates is dependent upon a number of economic variables. Historically, the most important of these have been:

1) U.S. prices compared to prices of other sellers.

2) Real income and population changes in importing countries.

3) Supply availabilities in the United States and importing countries.

4) Market access as determined by importing country policies.

More recently in the 1980s, financial factors have taken on greater importance as importing countries have had liquidity problems associated with large debt service and the exchange rate for the U.S. dollar has soared to historic heights.

These variables are reflected in the patterns of growth of U.S. agricultural exports over the past several decades. Between 1940 and 1972, U.S. agricultural exports increased at a steady average rate of $415 million per year in 1983 dollars. In 1973, primarily due to the entry of the USSR into the international market, U.S. exports jumped by about $7.4 billion. And between 1973 and 1981, U.S. agricultural exports increased at an average annual rate of $1.7 billion, four times the 1940-1972 rate.

This increase in the rate of export occurred for a number of reasons: growth in the world economy; an increase in world liquidity from the recycling of petrodollars; easy credit terms during most of the 1970s; a relatively low-valued U.S. dollar that made for inexpensive commodity prices; and production short falls in major consuming countries. The flexibility of U.S. agriculture to respond to these "demand shifters" by using large stocks on hand and bringing idle land quickly back into production allowed for an increased market share in a growing market.

The period of the 1980s has seen a reversal of many of these economic variables. The tight monetary policies adopted by the developed countries

in response to the second oil price shock of 1979 plunged the world into recession and caused U.S. agricultural exports to drop approximately $5 billion from 1981 levels. (See figure 1).

In addition to the overall downturn in world markets, the United States also lost market share. This was especially true for some crops where loan rates have a significant influence on market decisions. Wheat is a good example. The wheat loan rate strongly influences market price (see figure 2) thus leading to an unmarketable surplus when available supplies exceed demand at the loan price. With the exception of the early and late 1970s, the market price for wheat has closely paralleled the wheat loan rate. In these two periods strong demand raised the market price well above the loan rate.

In these periods, U.S. market share (shown in the lower portion of the graph) generally rose. In years when the loan rate was the major price determinant, U.S. market share generally declined or was less than the average rate as determined by the trend line. The conclusion to be drawn is that in years when the loan rate is at a level sufficiently high to be a major price determinant, U.S. market share for wheat will decline or be less than average.

Impact of U.S. Policies on Other Countries

If the U.S. loan rate has been successful in enhancing price for United States and other agricultural exporters, it will have increased price above what would have otherwise prevailed for the traditional importing countries. Such price enhancement has the dual effect of supporting these governments' efforts to increase prices and incomes for their own farmers at the expense of increasing food costs to consumers.

Perhaps the most important impact of U.S. farm programs on traditional importing countries is the security offered. The United States alone has sufficiently large production and storage programs to insure the world's food supply. We recognize that storage is a costly budget item but a certain level of inventory is necessary for food security and trade. The objectionable part is the tendency for some countries to rely completely on U.S. storage and avoid paying a fair share of the carrying costs of their own food security.

Not only do U.S. storage and land reserve programs offer food security, they also serve to dampen price fluctuations arising from unusually large supply or demand changes. While it is true that price instability has been rising in recent years, the magnitude of these price swings would no doubt have been greater in the absence of U.S. farm programs.

The ability of the newly industrialized countries to rely on U.S. food supplies has been an important factor in allowing these countries to be more venturesome in their agricultural development programs and in allocating resources from food production to higher valued uses. The end result has been faster economic growth for the importing country and larger exports for the United States.

Another program that tends to stabilize food supplies for other countries is Public Law 480. Since 1954, P.L. 480 has shipped over $33 billion of U.S. farm commodities to other countries.

The issue always arises as to how much disincentive is created by U.S. food aid in a given recipient country. Obviously, prices to producers would be higher in the absence of food aid, all else constant. However, food aid agreements are only signed based on conclusion of minimum disruption for local agriculture and the maintainence of usual purchases from commercial supplies. In addition, potential benefits to the overall economy may exist

in the form of lower consumer food costs and hence lower inflation, as well as the use of commodity sales proceeds for economic development.

In fact, U.S. agricultural programs including P.L. 480 make important contributions to agricultural development in the poorest countries. We are the largest source of food aid. We provide food security because of our storage programs that permit us to respond to both emergency and non emergency food needs. And we have the largest program of technical assistance. Although often overlooked, the use of foreign currency funds generated by the sale of P.L. 480 commodities sometimes represents the largest source of U.S. funding for programs to improve domestic agriculture in recipient countries.

In the livestock sector we typically have no direct price support policies; however, import restraints, when in effect, provide some domestic price enhancement. It is possible that these quotas have had a negative impact on some potential exporters in some years although the effect is lessened by allowing the quota to increase as consumption increases. The world dairy market is highly government-managed, with all countries providing subsidies and import restraints. It is difficult to determine the impact of U.S. programs on others in such a setting.

Several other commodity programs are worth mentioning. The sugar program provides price supports to sugarbeet and sugar cane producers. The current loan rate is 17.5 cents per pound for raw cane sugar 20.86 cents per pound for refined beet sugar.

The international sugar market is a good example of the interdependence of national policies. In late 1980 and early 1981 the European community drastically increased its exports of sugar causing the world price to fall. By spring 1981 it was apparent that the world price would fall enough that the Secretary of Agriculture would be unable to insure the integrity of the

sugar program and maintain legislated price support levels with existing authority to impose duties and fees on sugar imports. Thus quotas were imposed on imports to protect the operation of the legislated sugar program without major purchases of domestically produced sugar by the Commodity Credit Corporation (CCC).

Sugar and the sugar program represents a commodity in which substantial room exists for more market orientation. However, there must be greater recognition and less market interference by exporting countries which subsidize their exports of sugar before the United States can acheive the goal of adjustment to world market prices.

The honey and rice programs are other examples where domestic programs have limited our international competitiveness. The national average support price for 1984 crop honey is 65.8 cents per pound, up 3.6 cents from 1983. The program provides market stability to honey producers and encourages maintenance of bee populations that are vital for pollination of important seed fruit and vegetable crops. Nevertheless at that level of support the CCC will be in the position in 1984 of purchasing up to 50 thousand metric tons of the domestic crop while 40 percent of U.S. consumer demand is satisfied by imported honey. The 1984 rice program calls for a national average loan rate of $8 per hundredweight (CWT) and a target price of $11.90 per CWT. At these prices U.S. rice has been undersold by rice from Thailand by $120 per ton to Mexico, right at our back door.

A final example is the tobacco program. While the Tobacco programs are presently operating through producer assessments with no net cost to taxpayers, tobacco prices have been stabalized and marketing quotes established at levels that resulted in 232 million pounds of burley valued at $567 million under government loan on 30 September 1983 and 676 million

pounds of flue cured valued at $1.27 billion under government loan on July 1, 1983. This is up from 0.6 million pounds of burley and 531 million pounds of flue cured under government loan the year previous, respectively.

Not only has growth in our exports of tobacco almost stopped, producers have asked the government to protect them from lower cost import competition. An important point that is often missed is that export sales of tobacco products, mainly cigarettes, are still strong.

These several programs where government directives have replaced market signals provide substantial opportunity in coming years for more market orientation. We accept that such change is difficult and can only be accomplished if the resulting social disruptions are dealt with meaningfully. But the necessity is to move toward greater competitiveness and to reduce pressures for import restrictions or export subsidies.

Conclusion

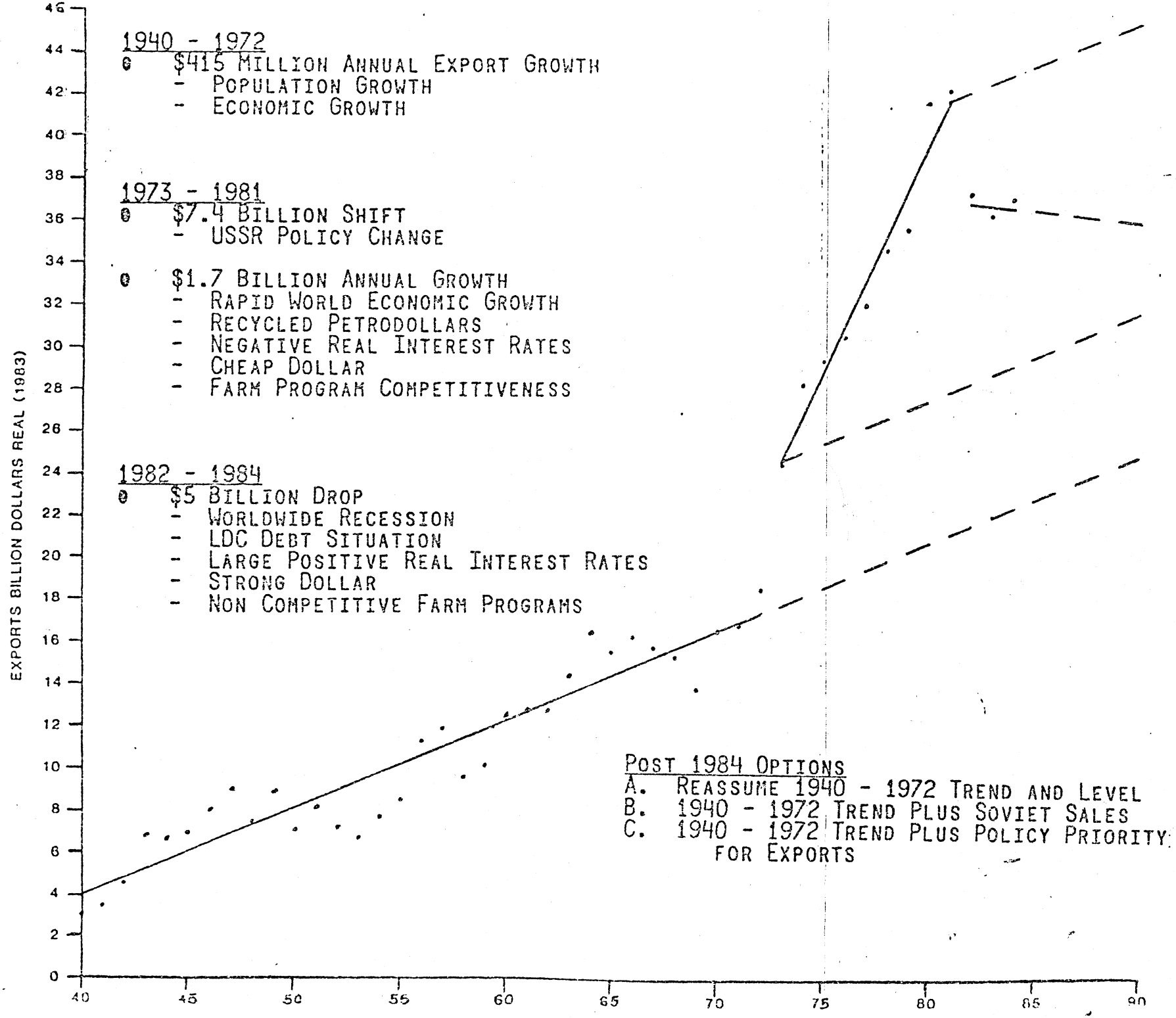
Future U.S. agricultural programs could have a potential detrimental impact on the less developed countries and the United States as well if we allow ourselves to succumb to protectionism.

We have always advocated a free trade position as befits the world's largest agricultural exporter. This philosophy is even more important today when many of our best potential customers are hard pressed to meet debt obligations. If we diminish export opportunities for these countries, it not only creates greater debt servicing problems for them but virtually guarantees they will not be able to earn foreign exchange to buy our products.

We need always to be mindful that protecting one small product in this country, whether agricultural or industrial, imposes lost export opportunities for all of U.S. agriculture. This administration has strongly

resisted these pressures. We must continue to lead the way in insuring that our agricultural programs move toward free trade for the greater benefit of U.S. agriculture and the rest of the world.

Figure 1



1940 - 1972

- $415 MILLION ANNUAL EXPORT GROWTH
  - POPULATION GROWTH
  - ECONOMIC GROWTH

1973 - 1981

- $7.4 BILLION SHIFT
  - USSR POLICY CHANGE
- $1.7 BILLION ANNUAL GROWTH
  - RAPID WORLD ECONOMIC GROWTH
  - RECYCLED PETRODOLLARS
  - NEGATIVE REAL INTEREST RATES
  - CHEAP DOLLAR
  - FARM PROGRAM COMPETITIVENESS

1982 - 1984

- $5 BILLION DROP
  - WORLDWIDE RECESSION
  - LDC DEBT SITUATION
  - LARGE POSITIVE REAL INTEREST RATES
  - STRONG DOLLAR
  - NON COMPETITIVE FARM PROGRAMS

POST 1984 OPTIONS

A. REASSUME 1940 - 1972 TREND AND LEVEL
B. 1940 - 1972 TREND PLUS SOVIET SALES
C. 1940 - 1972 TREND PLUS POLICY PRIORITY FOR EXPORTS

Figure 2. Relationship between U.S. Market Share for Wheat and Market Prices - Loan Rate, 1960-1983.